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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Monday, 17 June 2002

Members: Senator Chapman *(Chairman)*, Mr Griffin *(Deputy Chair)*, Senators Brandis, Conroy, Cooney and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Brandis, Chapman, Conroy, Cooney and Murray and Mr Byrne, Mr Ciobo, Mr Griffin and Mr Hunt

Terms of reference for the inquiry:

Statutory oversight of the Australian Securities and Investments Commission

WITNESSES

Committee met at 7.36 p.m.

COLLIER, Professor Berna, Member, Australian Securities and Investments Commission

IGLESIAS, Mr Carlos, Executive Director, Infrastructure, Australian Securities and Investments Commission

JOHNSTON, Mr Ian, Executive Director, Financial Services Regulation, Australian Securities and Investments Commission

KELL, Mr Peter, Executive Director, Consumer Protection, Australian Securities and Investments Commission

KNOTT, Mr David, Chairman, Australian Securities and Investments Commission

RODGERS, Mr Malcolm, Executive Director, Policy and Markets Regulation, Australian Securities and Investments Commission

SEGAL, Ms Jillian, Deputy Chairman, Australian Securities and Investments Commission

WOOD, Mr Peter, Executive Director, Enforcement, Australian Securities and Investments Commission

CHAIRMAN—I declare open this public hearing of the parliamentary Joint Statutory Committee on Corporations and Financial Services. Today the committee is conducting its public hearing into the Australian Securities and Investments Commission. The Joint Statutory Committee on Corporations and Financial Services is required by statute to oversee the functioning of ASIC. This hearing is part of that oversight. I welcome to this hearing Mr David Knott, the chairman, and other officers from ASIC.

Witnesses should note that the evidence given to the committee is protected by parliamentary privilege. I also remind you that the giving of false or misleading evidence to the committee may constitute a contempt of the parliament. I remind officers that an officer shall not be asked to give opinions on matters of policy but shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister—not that there are any ministers present. I also wish to say that, unless the committee should decide otherwise, this is a public hearing and, as such, members of the public are welcome to attend.

May I also apologise on behalf of the committee. I understand that we have somewhat inconvenienced the chairman with his attendance at the hearing this evening. Unfortunately, with 30 June approaching, it was our only opportunity to conduct our statutory oversight of ASIC. It was the only night that we found committee members were available. I do apologise for that. I did think it was important for the chairman to be here, given that it is the only hearing we have had for this 12-month period with the commission. But I do apologise for any inconvenience we may have caused you.

Mr Knott—Thank you, Mr Chairman. I understand the position.

CHAIRMAN—Do you wish to make an opening statement?

Mr Knott—No, I think we will make ourselves available to questioning by the committee.

CHAIRMAN—Okay. We will move to questions.

Mr BYRNE—In the briefing note, you have some information about prospectuses. I wanted to get your view about some of the prospectuses that are on offer on the markets, particularly in the agricultural sector, and what is happening in terms of tightening the surveillance of those prospectuses. I am interested in your views on that.

Mr Knott—I am happy to start the answer to that question and I then might ask Mr Johnston to add to the answer. For some time now—some 18 months—we have been focused on the disclosure issue in prospectuses generally but particularly what we would regard as high-risk prospectuses. They do include some in the agricultural sector. Our prime focus has been on forecasts in those prospectuses and whether or not they are reasonably based. There has been some history of constructing a house of cards based on assumptions that are not reasonably based, which makes it very difficult then for us to take action of any sort if the offer fails—if the investment fails. The issuers simply point to all the assumptions that were made, and it is difficult to retrospectively say that people were misinformed. So we have done that.

We have been more active in stopping prospectuses where we believe that there is inadequate or insufficient disclosure. The regime is fundamentally a disclosure based regime. That is to say, I think it has been the policy of governments of all political persuasions for a long time not to constrain investment parameters for the public and not to try to say what is too risky for investors to be in, but rather to make proper disclosures so that investors can make up their own minds. So we have been very much focused on trying to make that more effective. That is the general position we are in, but Mr Johnston may wish to add more detail.

Mr Johnston—As the chairman said, our focus has really been where we think the highest risk is. The committee would recall that it is not the role of ASIC to vet prospectuses. Prospectuses are not registered by us any more; they used to be some time ago. They are now lodged with us, and there is an opportunity for us to look at some of them on a measured basis, whereby we go through and look at a certain number, or where matters are drawn to our attention or where we believe, through past experience and the history of the issuer, that there are specific issues we should look at.

In the managed investments area—not just agricultural schemes, but managed investments generally—some 1,700 or so prospectuses, offer documents, were issued during the period covered by the report. Some 80 or so stop orders were issued. They tended to be the on the sorts of matters the chairman referred to. In the vast majority of the cases, the stop orders were lifted when additional disclosure was made. But in some cases, we had to take stronger action and pull prospectuses off the market. I think the chairman has outlined that philosophically the law now works in a way which is a disclosure based regime. We look at breaches of disclosure, but it is really not our job to intervene unless there has been a breach of the law.

Mr BYRNE—Do you have a section within the department that specifically examines the prospectuses?

Mr Johnston—I guess we would divide it in two. There are the managed funds based offer documents, which my team would look at, and financial services. Then there are the capital raisings more generally, which Mr Rodgers may comment on. Within the financial services area, dealing with managed funds offer documents, we do have a team that looks at them on a risk basis. But we apply a risk framework that looks not only at the document itself but the offeror. It might be that we believe this particular offeror has a history that would warrant us looking at their offer documents. I have three teams sitting within financial services and it is the job of one of those teams, among other things, to look at offer documents.

Mr BYRNE—You say you take a representative sample of prospectuses that are issued rather than look at them in totality. What you do is sample them; is that correct?

Mr Johnston—Yes, it would be a small sample, though, because we try to do it on a risk and targeted basis. The other thing I would point out, of course, is that under the new legislation, the Financial Services Reform Act, prospectuses are no longer required to be lodged with us. We will now receive a notice that an offer document has been issued, but no copy is sent to us. We may still elect to have a look at that document, of course.

Mr BYRNE—So you have to wait until it is out on the market to see whether there is a problem with prospectuses?

Mr Johnston—Yes. There is no pre-vetting.

Mr BYRNE—Do you see that as a being a flaw in the system at all?

Mr Johnston—We have moved to that regime; it is our job to implement that. I do not think I can express a view as to whether we should turn the clock back or not.

Mr BYRNE—Of that representative sample of prospectuses, how many do you have difficulties with in percentage terms?

Mr Johnston—I am not sure I could quickly enough calculate the percentage for you. We issued, during the period covered by the report, somewhere around 80 interim stop orders.

Mr BYRNE—How many samples would you have issued?

Mr Johnston—There were about 1,700 managed fund prospectuses. That covers the whole range of managed funds: cash trusts, equity trusts, mortgage funds et cetera.

Mr BYRNE—I have started the ball rolling, so I am happy to just pass it on to other members for the time being.

Senator MURRAY—Mr Knott, I will start by congratulating ASIC on your regular supply of press releases, which are very informative in terms of the activities undertaken in all areas. It does seem to me to either indicate a very much more geared public relations department than there used to be, or else you are more active than you used to be; you can choose which one you want to respond to. Certainly it is quite impressive, from a regulatory oversight point of view.

Going back to those prospectuses, I have the impression that this new system actually results in more attention and more market signals on what is required with prospectuses than used to be the case. I have the impression that the system is actually working better than it has in the past. Would that be a right impression? You talk about 1,700. Do you measure the salutary effect of your 80 stop orders and your discussions?

Mr Knott—Again, I will start and Mr Rodgers may want to add. We have to be clear what we are talking about when we say the 'new system', because it has come in two stages. The first was the change in law under which prospectuses were no longer registered with us but merely lodged. The most recent change, of course, is the one that Mr Johnston is referring to, where some types of offers are covered by, effectively, offer documents that are no longer lodged at all.

If I understand it, your question refers to the fact that we seem to have been more active in stopping prospectuses. Certainly that is true. It is hard, though, to make a qualitative assessment between a regime where more was done before prospectuses were issued and a regime where more is done now after they are issued but in a short period before the subscriptions close, which is where most of the activity occurs, if we can achieve that. Certainly when that change was made, we made it clear that we would be issuing more stop orders because that really became the only effective means by which we could respond. It is fair to say that historically we would—through originally the pre-vetting processes and then, after vetting stopped, a process by which people came to us before their prospectuses were issued to talk about them—be able to influence disclosure. My response on that particular issue would be that it would be difficult to make a qualitative assessment. It would be wrong to assume that because there are more stop orders in the market at the moment than there have been means it is a better or worse system. I think it is very hard to make that judgment.

Senator MURRAY—My interest is this: if the effect is not to knock out those practitioners who are repeat offenders—the market will do that; somebody who gets a lot of stop orders or who has a lot of failures will not get repeat business—you need to look at what else needs to be done. If the effect is that people will be knocked out of the market or will improve their game so they do not become repeat offenders, obviously the new system and the combination of those two changes is working.

Mr Knott—If you combine the regulatory change I described—that is, the policy relating to forecasts—with the stop order mechanism, I think it has worked. In other words, if you look at the last 18 months or so, ASIC's approach to the use of forecasts in prospectuses has been as important as any other change that has occurred. What we have seen is a number of what we would regard as high-risk prospectuses either being knocked out of the market or undergoing refinement by the addition of more disclosure, or the inclusion of additional disclosure.

Senator MURRAY—You have had interaction with the ATO, for instance, on mass-marketed tax effective schemes. The prospectuses out there had two main faults. One was that their dominant purpose was to avoid tax. The other was forecasting, and the estimates were overblown. Has the combination of the ATO worked very effectively, do you think?

Mr Knott—Mr Johnston may answer it directly because he has probably had more to do than anyone at this table with the ATO in those discussions. Overall, the responses of the two agen-

cies together have been effective. There is still, I think, an open question about whether enough has been done to stop the supply side of these high-risk issues. To the extent that that is a tax-driven question and depends on the view that the ATO takes, I am not sure that we are completely able to answer that question, although my colleague may wish to try. I certainly think in combination we have made ground, yes.

Senator MURRAY—Before you try, let me add one more framework for you. The ATO product ruling system requires it to establish commerciality and to rule out those methods of financing which are purely tax driven. But to arrive at an understanding of commerciality is not just a tax perception as to whatever benchmarks you can find in the marketplace for those kinds of schemes and whether they give a commercial return. It is also affected by the views you would take, I would think, on things like forecasting, estimation and expert opinions and those sorts of things. I wonder how well those two areas are working.

Mr Johnston—I think we can go some way to answering it inasmuch as if you look at the experience over the past 12 months and a little beyond that, there is no doubt that the number of raisings in that sector has reduced. The market participants tell us that that is due to a combination of the activities of the tax office and the position we have taken, particularly in respect of forward looking statement projections. The reduction in the number of schemes that are offered—I would venture to say that it does not mean that all those being offered are good, not by any means—means that the far riskier ones have dropped out of the market, at least to an extent, because of the reduced number of offerings. It is hard to say how much of that is due to the position we have taken on projections and how much is due to the activities of the tax office, but it must be some combination of the two, one would expect.

Senator MURRAY—Is any result of your action and the ATO's action—broadly speaking, you are in the same field of making sure that managed investment schemes are genuinely commercially driven and are realistic as approaches— generating a demand for greater training or more guidelines from you for the market to be more informed as to what regulators regard as acceptable?

Mr Johnston—When you refer to the market, are you referring to the market participants as opposed to the investors?

Senator MURRAY—Yes.

Mr Johnston—To the issuers?

Senator MURRAY—To the people who put together these schemes: the promoters, the issuers, the scheme designers.

Mr Johnston—There is no doubt that the market participants have come to us seeking guidance. The market is aware that the relevant policy statement that affects these schemes in terms of the projections was out there as an exposure draft and is being reviewed by us just now. The market is aware of that. In various places around the country, particularly in Western Australia, we have conducted several meetings and seminars et cetera with scheme operators to help them to understand what our requirements are, and with their advisers. We have done that

over the past 12 months or so on a fairly regular basis, particularly in Perth, where many of the schemes originate.

Senator MURRAY—It's the wild west; you know that, don't you?

Mr Johnston—So I think on the one side, the issuer side, we have been doing quite a lot to help them understand what we are looking for in terms of projections and what we are not looking for in terms of projections. At the same time, we have been trying to, on an ongoing basis, raise the awareness of the investor in these types of schemes about what to look for and what questions they should ask before entering into them.

Senator CONROY—The good news is that I only have one question. It is great to see you all again so shortly after we last saw each other. I asked Mr Johnston, and, from looking at the *Hansard*, Mr Rodgers took the question, whether or not we had Professor Ramsay's report with regard to the options for better disclosure. You said it was due soon. I was wondering whether it had arrived and was available yet.

Mr Rodgers—We have received the report, but we are still in the process of reading and digesting it. It is in a draft form at this stage. So we have not received the final version of what will come to us.

Senator CONROY—Do you have any idea how soon that will be? How long is a piece of string?

Mr Rodgers—All I can say reliably is that we are due to have a discussion internally next week as to what we think needs to be done to bring it to a final form. We will discuss that timetable from there.

Senator CONROY—Commiserations for Carlton and its ongoing woes.

Mr Rodgers—Thank you, Senator.

Mr HUNT—I have a question for Ian Johnston. When you spoke on this issue before the estimates committee on 6 June with regard to the Financial Services Reform Act, you said that perhaps there should be law reform in respect of the tax driven industry. I was very interested in what you thought was the possible gap or lacuna which exists and why you would speculate on that. What is the possible nature of the reforms that you might be considering as necessary?

Mr Johnston—The chairman earlier referred to the fact that perhaps the supply side needs to be addressed. I think that went some way to pointing to our thinking. We are in a position whereby we have to regulate a sector of the market and apply significant resources to it. My best guess would be that the tax-driven end of the managed funds market makes up something less than five per cent of funds under management in that sector. Of my surveillance resources, it takes up about 30 per cent of those. There is a very disproportionate response that we have to make to these types of schemes.

Why is that? We have talked about the disclosure issues that are there. Another reason is that the number of complaints we receive in respect of the conduct of the schemes causes us to de-

vote a large number of resources to it. There are other jurisdictions around the world that do not permit these types of ventures to be offered by way of public subscription. It is a matter for government in terms of its policy as to whether tax deductions should be given and whether these types of schemes should be available for public subscription; that is really for the government to determine. But I guess we are noting the fact that we seem to be faced with a disproportionate response in terms of resources to the size of the industry. We are nowhere near a final view, I have to say, but we are considering within ASIC, if there were to be reform in this area, what it is we would wish to see.

Mr HUNT—Are there any preliminary indications of at least the issues, if you are not in a position to talk about the outcomes?

Mr Johnston—We have identified the offer documents themselves. We have done some work in what changes could be made to the prospectus or offer document regime. We have done some thinking along those lines. For example, some of the complaints we receive still say that these are being sold on the basis that ASIC has somehow approved the scheme. Perhaps there should be some stiffer penalties for people who make those sorts of claims. Investors often tell us that they were told by an adviser or promoter that this scheme somehow had the approval of ASIC.

Senator MURRAY—Is that not false and misleading under the ACCC?

Mr Johnston—It could be false and misleading under our own head of powers, but it is not always easy for us to get enough evidence to mount that sort of case in terms of any intent that is there. If we were able to establish that that sort of statement had been made and that perhaps there was strict liability attached to it, that might be easier for us.

Mr HUNT—Are there any other possible legislative issues associated with this?

Mr Johnston—I do not think we are advanced enough at this stage, to be frank. We are looking at what happens in other jurisdictions around the world, through our membership of IOSCO. But I do not think we are nearly advanced enough to comment just now.

Mr Knott—I will add something in response to Mr Hunt's question. To some extent from a policy perspective, if you have to decide whether this is a revenue protection problem or an investor protection problem, your policy response will depend on your fundamental view about that question. If it is essentially an investor protection problem, the traditional response in Australia would be a disclosure based response: is the current level of disclosure enough? Should more be done? Should the regulator have more power to intervene? Should there be more health warnings on prospectuses to make it clear that the regulator does not carry any sort of sponsorship or responsibility? It is those sorts of issues.

If it is a revenue protection issue essentially—that people are just going into these things primarily for tax deductions, which should not be provided—your policy response will fundamentally be designed around the ATO and how the ATO should manage that problem. At this stage, there is a perception that it is a little bit of both, which is why both agencies have been seeking to address it.

Senator BRANDIS—Presumably, in terms of your statute, you would conceive it as probably the former?

Mr Knott—Certainly from the way we can respond, it has to be in relation to those aspects. It is not to say that we think in many of these cases it is about investor protection. I need to qualify that answer so it is clearer. I think it is quite clear that there are many cases where people go into these schemes approaching 30 June for almost no other reason than the tax deduction. They are not particularly concerned about whether the scheme will be commercially viable three or five years down the track. In relation to those types of investments, one I think is legitimately able to ask how concerned are we about protecting them as investors or how concerned should we be that what they are really doing is assaulting the revenue.

Mr Johnston—I will add a comment there to reinforce that point. The type of complaint that we receive, or rather the time at which the complaint is received by us, is generally when someone has lost their tax deduction. It is not generally when someone comes to us and says, 'I have lost my money.' It is usually that they have lost their tax deduction.

Mr HUNT—My next question is about the balance between complaints about unscrupulous operators and complaints about rulings, primarily by the ATO, which have disadvantaged investors.

Mr Johnston—I think it is fair to say that complaints about unscrupulous operators and disclosure being incorrect et cetera tend to follow after they say they have lost the tax deduction. But that is not for a moment to suggest that they are not being mis-sold. We then investigate whether there has been mis-selling. We take that as a consumer protection issue. That is generally what gives rise to the claim in the first place—the tax deduction loss.

Mr Knott—We did at an estimates hearing the week before last describe a particular surveillance program that we have in place which has sought to identify these types of schemes which have been paying very high commissions to the promoters. We have been looking at those because they seem to us to represent the greatest risk about mis-selling: that there is more in it for the promoter to simply sell these products regardless of their suitability to the customer. Obviously, high commissions would be relevant to that. That is a project that we have under way at present.

Senator MURRAY—Where the commissions are taken up-front, there is even more of a warning signal.

Mr Knott—Yes.

Mr CIOBO—I want to touch on a couple of issues, if I may. Something that has been an issue in my local area of the Gold Coast is the role of property seminars, negative gearing and all these types of things. I would be interested initially in your comments on ASIC's role with respect to consumer protection, TPA aspects aside, given that that is for the ACCC. From an ASIC perspective, what is your role in that type of market environment, where it can lead to a total degradation of consumer confidence in a relatively short period of time? I am interested in your comments.

Mr Knott—The short answer is a jurisdictional one. ASIC did prepare a report—it must be almost 18 months or two years ago now—which looked at this whole real estate area and was very conscious of seminars and the like and high-pressure tactics. As you say, it was very much focused on parts of Queensland and, in particular, the Gold Coast. We issued quite a comprehensive report about the practices and the dangers of those practices from a consumer point of view. We pointed out that most of that activity is covered by the state jurisdiction. We raised the possibility that it might be a source of reference for Commonwealth jurisdiction because of our concern that until and unless that happens it will be very difficult to have consistent regulation of the activity. The activity does, of course, cross states. These seminars will often take place in Victoria and result in investment in Queensland. It is my understanding that the government wrote to the states following the production of that report to see what, if any, interest there was in the Commonwealth assuming some additional jurisdiction. But I do not think that has gone anywhere substantively in the intervening time.

Mr CIOBO—What sort of structure do you see being in place in terms of a legislative framework that might address that? Is there a model that we could pick up on, or does it require greater national coordination, or a combination of all these things?

Mr Johnston—In terms of providing a full jurisdiction to ASIC, it would require effectively a referral of powers to clearly bring the full range of activity under the Corporations Act. I will ask Mr Kell to amplify the answer.

Mr Kell—You mentioned the fact that often these real estate seminars are linked with a credit facility. As of 11 March, ASIC gained Commonwealth level consumer protection responsibility for credit from the ACCC. That is not the sort of power that applies across the rest of the financial services sector under the Financial Services Reform Act. It is not the licensing provisions or the disclosure provisions, but it is rather the powers that we have under the ASIC Act: prohibitions against unconscionable conduct and misleading and deceptive conduct. Those powers are fairly well known.

That jurisdiction, then, is quite new to ASIC. But we are currently undertaking a fair bit of work to establish what we might do in the area of regulating credit and assessing where some of the higher risk areas are. Certainly the area of so-called ‘get rich quick schemes’ and hard-sell schemes involving credit is one that is on our radar screen. We are looking to assess whether we can do some work in that area in the next year or so. But at this stage we do not have any particular areas in mind.

It would still be difficult for us in that, while we would have the credit side, we would not have the real estate side. In terms of the ease of dealing with it from a regulatory perspective, you still have the problems that, if you like, only half the equation generates.

Mr CIOBO—With respect to two-tier property marketeering, when you have the provision of credit from an associated entity generally, as I understand it anyway, you are saying that that is potentially on your radar screen as an area for further work?

Mr Kell—We receive complaints about it. It is one of the reasons why this report was generated. At the moment, we are still in the stage of assessing what risk areas in the provision of credit will be the ones we will look at. We are obviously very aware of the fact that state

governments, again, still have quite a significant role in the consumer protection area when it comes to credit under the uniform consumer credit code. There is no use us simply duplicating what the state governments are doing. We have to make sure that we are targeting areas that may miss out on that state based regime.

Mr CIOBO—A separate issue with regard to MIA, again, specifically for the Gold Coast—I am sure it is shared elsewhere—is strata title units. It still continues, from what I hear, to be an ongoing issue. Again, what is ASIC's view? What is the principal way that we can perhaps bed some of these issues down once and for all, especially the perception in the marketplace that 'We are considered a financial product whereas everything else is considered a real estate product. They are exempt and we are not. We carry this greater legislative burden of having to disclose and have all these checks and balances there that do not generally apply to real estate' et cetera? Again, I am interested in your comments on that.

Mr Johnston—In terms of where they are structured as managed investment schemes, what you are referring to is the fact that we have been quite active in pursuing some of the misdemeanours that have taken place in the marketplace. There is, as you say, the jurisdictional split that makes it very difficult for us. It makes it difficult too for the operators, who say 'I am now subject to a number of restrictions that other people are not.' I do not think there is anything we can do about that. If there is misconduct taking place under the MIA legislation, we are duty-bound to follow it through and take action against people.

Mr CIOBO—In terms of the classification of the strata title structure and the issuing of prospectuses and what not, all within the context of the MIA, are there still ongoing discussions between industry and ASIC on that?

Mr Johnston—Yes. There were some discussions held just within the past couple of months. We were in discussion with IFSA on that as well.

Mr CIOBO—So can you make any predictions?

Mr Johnston—No. It is still under discussion.

CHAIRMAN—On a related issue, does the marketing of timeshare investments come under your jurisdiction?

Mr Johnston—It can come under our jurisdiction, depending again on how it is structured.

CHAIRMAN—Can you enlarge on that?

Mr Johnston—Timeshare is a difficult issue inasmuch as, again, it is area where, if it comes under our jurisdiction, we take action in respect of it. But it can be structured in such a way that it does not come under our jurisdiction. It would again require some law reform if it were all to be brought under us. Some of it still comes under the states. Generally, it is the consumer affairs departments within the states that look at it.

CHAIRMAN—What is the determining factor as to whether it comes under your jurisdiction or under the states in terms of structure?

Mr Rodgers—The way that many timeshare schemes are structured does bring them under the jurisdiction, because they have all the characteristics of what the law requires to be a managed investment scheme. The tension has been that they are not perceived in many cases to be an investment of the same kind as an investment in a cash trust or a share trust. But it has always been part of that category of what is now called managed investments that it does catch things that are, as it were, from time to time quite close to the fringe of what amounts to investment activities. I mean, it has always been our understanding that it was the intention of the parliament in the old prescribed interest scheme and the new managed investment scheme to achieve that effect.

What we have done in the case of both timeshare and strata schemes is try to facilitate the adaptation of the managed investment regime so that it does allow people to proceed in promoting and using these schemes but with some modifications. This is an area where we have provided some quite extensive relief, historically, in order to facilitate it. I must say that it is not always popular with some operators because, I guess in their minds, what they see themselves doing is a real estate transaction rather than an investment or a financial product transaction. Sometimes it takes a little while to work that through the system; that is certainly true with strata schemes. We have maintained close contact, I think, with both the strata industry and the timeshare industry. But it will go on being a difficult area, I think, because perceptions are quite different about how people approach these things both as issuers of the products and, from time to time, as purchasers of the products.

CHAIRMAN—I raise the question because earlier in the year I was contacted by one of these groups. I thought I would go along as chairman of the committee just to see how they operate and what they do. At the end of the presentation there was the high pressure to sign on the dotted line. There was no prospectus issued or anything. It was sort of 'Sign now.'

Senator MURRAY—And pay.

CHAIRMAN—That is right.

Mr Rodgers—No doubt you were wise enough not to sign.

CHAIRMAN—Indeed. Even real estate would be subject to the cooling off period?

Mr Rodgers—That will vary according to state law on the sale of real estate. If it really is a product that has no investment component, it will vary from state to state because the consumer protection rules for the sale of real estate vary on a state basis.

CHAIRMAN—This was a group that seemed to have relationships with properties both interstate and overseas. They did have a property in South Australia, and they were making their presentation in South Australia. How does the interstate jurisdiction work?

Mr Rodgers—I would not pretend to be an expert on this. Unless they are a financial product, there is no Commonwealth scheme that I am aware of for the regulation of real estate activity. If they are dealing in South Australia and in some other state, they will need to comply with the relevant laws of each of those states. Again, I stress that I am not an expert in this area.

Mr CIOBO—On that matter, I know in the United States that, with respect to timeshare, across all state jurisdictions there is significant specific timeshare legislation that seems to operate, from everything I hear, very effectively. Is the US model a good model? Have you had any exposure to it? Would it work in Australia? It seems to me that there has been a certain amount of professionalisation of the timeshare industry from the late 1980s through to now with the entrance of RCI, Trend West and so on and so forth?

Mr Johnston—I couldn't say that I have looked at it, I am afraid.

Mr CIOBO—Has anyone looked at it?

Mr Knott—I am not quite sure whether you are referring to it as regulation from a real estate perspective or an investment perspective.

Mr CIOBO—I am asking out of ignorance because I have just been told that the US model works very well. It is something I have to do further research on. I wondered whether anyone from ASIC had looked into the US model. It is applied on a state basis and not at a Commonwealth level.

Mr Rodgers—I cannot help you, Senator. I do not have reliable information on it. All I am aware of is that there has been, as you point out, some influence because of the presence of some American firms in the business in Australia. I do not understand it to be regulated as an investment product in the US in the same way that it is regulated in Australia.

Senator MURRAY—Mr Knott, do you have an executive responsible for preventing shredding yet?

Mr Knott—We have not seen a need, Senator.

Senator MURRAY—It is a serious question, but it may not be seen that way. It seems to me that the law with regard to the retention and preservation of records may in fact allow for some gaps to emerge. If you were in the process of being investigated or there is a likelihood that you might be charged, then, as they have found overseas, shredding evidence ends up being a crime. But if you are not at that stage, you are not in any litigation and you comply with the seven-year keep your records rule and so on and so forth, there is a danger that the archiving practices of different companies may result in the destruction of records which subsequently would be useful from a corporate law regulatory basis. I wondered whether, because of the events in this country and overseas with the tobacco companies and energy companies and with former governments in Western Australia and places like that, the issue of records is reaching a higher level in your in-box than it might have before?

Mr Knott—First of all, I will go to the issue itself of what is a record or what is not a record for retention purposes. It is my understanding that various laws require various records to be retained for minimum periods, but not all records. Books of account and other tax records et cetera all have particular mandatory retention periods, including key records under the Corporations Act. We will, for the purposes of this discussion, take seven years. There is a separate set of issues about records that may be required in litigation. Some of the recent cases we have seen relate to those issues. I do not believe that the issue of defined records being retained for a

minimum period has been at issue with the couple of cases we have seen. What has been at issue is whether when people destroyed records they were effectively in contempt of court process because of perceived litigation.

In that respect, the obligations are fundamentally laid down by common law. What we have seen is various legal firms give opinions about what is required or not required. We have seen at least one case where a firm was severely criticised for a practice that was adopted allegedly in response to the firm's advice. I do not think it would be practical to say that business must keep every piece of paper or every record it has, regardless of its content, forever. I think you would agree with that.

Senator MURRAY—Yes, of course.

Mr Knott—The traditional approach, as I understand it, has been to identify those records which, for regulatory, tax or other particular reasons, are prescribed as being special and subject to mandatory retention for a period. In our experience, and certainly in my own experience, I do not think we have had any particular problem in that area except the one we constantly run up against, which, of course, is companies not keeping proper books of account. When liquidators enter into possession, they find that the trail is virtually lost. We have historically pursued those actions, but they result in summary prosecutions. It is after the event anyway. The bigger issue that you are referring to really relates to the state of the common law in relation to records that may be relevant to litigation or expected litigation. I suspect that we will see some more common law before too long.

Senator MURRAY—Or sensitive issues.

Mr Knott—Sensitive issues that may reasonably be expected to be at issue in litigation.

Senator MURRAY—That is right, particularly in environmental areas and areas of that kind where public health is at risk.

Mr Knott—I am not sure that I have answered your question adequately. To the extent that I have thought about this issue, the fundamental approach of government identifying those areas of sensitivity which require special record retention law is sensible. Then there is the question of what the common law is going to say about document destruction policies in cases where a court, even looking retrospectively, says there was a reasonable expectation that that document would be relevant to an issue in future litigation. I run the risk of getting out of my depth here, but I think at the common law the general approach has been that, unless litigation is commenced or you are on notice of commencement of litigation, you do not commit an offence by destroying documents which are not as a matter of statute required to be retained.

Senator MURRAY—That is right. If I read the literature correctly, Andersen in the United States were close to putting up a reasonable defence that they were conducting the normal sorting out of those documents which should be kept and those documents which should be destroyed. My instinct is that three things are happening. Firstly, as I have described in other areas, I think there is a parting of the ways in terms of law. That law which affects entities and individuals within entities is going to allow for far greater access by regulators and law enforcement agencies than laws which affect individuals. You can see all the strict liability regimes that are

emerging, the reverse onus of proof, the demands to produce information and all that kind of thing. That is one side of things that is happening.

The second side is the lack of genuine retrospectivity constraints in serious matters. For instance, the tax office at part 4 can just disregard any idea of retrospectivity. They can go back a long way. That applies to a number of other high public interest issues, where you can make application to a judge, for instance, to set aside the statute of limitations and so on.

The third area is the area of foreseeing the future. Governments would not have covered the ground in terms of what documentation should or should not be kept. Therefore, when governments have to deal with this, they will turn to people like yourselves and say, 'Where are the holes? Where are the gaps?' My questions to you really were: have you started thinking about this? Are there holes or gaps emerging in your own view or experiences as a regulator which mean that you would have to start to examine the issue of what kinds of documents might not be kept which should be?

Mr Knott—It is a fascinating area that you have opened up because it is so broad. I will turn, in answer to the last part of the question, to our own experience. We have extensive experience of companies' books of accounts being inadequate. In fact, the companies have breached the law in terms of their obligation to maintain proper books of account. The question is what you do about that. Quite clearly, in the absence of a system of inspection from the regulator, one is fundamentally relying on the auditors, if it is an audited company—and often it will not be, of course—to indicate that proper books of account have been kept.

Senator MURRAY—Or the tax office.

Mr Knott—It could be the tax office, yes. I do not know whether anybody else at the table on my side would like to contribute to this. I would say that that is the area that is almost commonplace where the law is not being observed at present. As I said before, there is usually some summary consequence after the event when it emerges. Usually it is when the company has gone insolvent. It is one of the limitations on running a full insolvent trading case—the lack of adequate company documents. It is quite perverse in its way, if you think about it, that a company that traded while it is insolvent should be protected from the consequences because it has not kept proper books of account. But it often is a contributing factor.

Senator MURRAY—If you were deliberating doing it, it would be the obvious strategy, wouldn't it? In these phoenix companies, where you get the serial offenders, I assume, that is what they would do. They would know those areas.

Mr Knott—I am sure that does happen. I am equally sure that there would be many cases where part of the contributing factor to the collapse has been the inadequate maintenance of records and systems of control which reflects fundamental difficulties with the business: a lack of resource and lack of attention to that side of the business. It would be hard to gauge how much of it is deliberate and how much of it is actually causal. Yes, I am sure that there are unscrupulous people who make sure there is no trail.

Senator COONEY—It is a question of fact which makes it difficult. Look at the case that Justice Eames decided. That is what he was really saying. He was saying that if you look at this

as a matter of fact, you find that these people destroyed these documents when they should well have contemplated that there was an action in the offing. I do not think when they did destroy them there was an action going, but I think where he extended it a bit was to say that there was one in contemplation. That is always a question of fact, which therefore makes it very difficult to, as it were, state principles in respect of any particular case.

Mr Knott—On the destruction issue, that is right. I think that well summarises the earlier conversation on the destruction issue. On the non-maintenance of records themselves, there is a combination of companies that would deliberately ensure their records were inadequate and a great many other companies who simply do not have systems in place to ensure that they are adequate.

Senator COONEY—Wouldn't that be a question of fact too?

Mr Knott—Yes, it would.

Senator MURRAY—With the two recent customs bills which have been passed but have not yet been put into law, what the government has done is to say that, with a pretty-well hands-off regulator, which the customs department is—they just cannot go into every container or postal item coming through—they have imposed a highly transaction related system which has attached to it strict liability provisions for the provision of information in the form, manner and level of accuracy that they want. They will simply keep fining and punishing them until they get it right. There is a lot of antagonism to that by participants in the industry, naturally. I wonder whether that model or direction is feasible in your area where the documents that everybody must provide are the tax documents: your income tax return and your quarterly or monthly GST returns. They have to relate to primary books of account, I would have thought.

Mr Knott—I am not convinced that you could, through that system, be satisfied that the standard of account keeping and record retention in the small- to medium-business sector, which is fundamentally what we are talking about now, would ever be addressed to the extent that, for example, the difficulties we have with maintaining an insolvent trading case would be solved.

Senator MURRAY—That is probably right.

Mr Knott—The broad thrust of our law at that end of the market is to be pretty hands off. The small proprietary company issue, dare I raise it, separates that whole category of small business and relieves it from the requirements of reporting that are imposed from the large proprietary end through to the public company end. So there is this sector that is largely unregulated in that respect. That would be the sector that would be almost 100 per cent involved with your phoenix company type activity.

Senator MURRAY—The reason I am pursuing this is that I do not regard you as acting on your own. Throughout this discourse with you tonight, I have linked you with the ATO, because the two of you have a prime—certainly in one area of your work—requirement for the accuracy of the information provided. The government has just put together an initiative, which I think is a smart one, of giving the ATO lots more money to supplement the self-assessment scheme with a fairly rigorous inspection regime—they are going to go and physically check people's books.

An ATO person going to check that the data that they are putting into their GST return and their income tax return—their PAYE return—are all accurate has to, by nature of the job, look at the books of account. They have to, there is no other way you can do it. That means they would be doing, effectively, the job that you are not resourced to do. I am searching for whether you are alert enough to the opportunities of interacting with them, given that initiative, and assessing the scope and depth of some of the problems which relate to people not complying with a law which is there ultimately to protect everybody from people who deal badly and to preserve the revenue.

Mr Knott—Thank you for that. I understand better the direction of your question. Put in the particular context of on-site inspections by the ATO, which, for example, might disclose that the books of account are in total disarray, the question would then be whether the ATO would be empowered, motivated or incentived to bring that to our attention so that we could take some action in relation to the requirement under our act to maintain proper records. If that is the sort of example you mean, it is certainly not something we have discussed. It is something that I am certainly happy to take on board and see whether we think it would be practical, or what constraints exist at law for the sharing of that type of information, or, indeed, from a resources point of view, what it would mean for us to then step in and try to rectify that situation. Experience would suggest to me, incidentally, that the court—it would be a lower court, such as a magistrates type court—traditionally would impose a very small penalty on a company for an inadequate bookkeeping type offence.

Senator MURRAY—Which is why the customs legislation went to strict liability, because it is the automatic imposition of a fine at less than the imprisonment level. They do not like it.

Mr Knott—Are you content if we take it on board, look at it and examine what opportunities there may be?

Senator MURRAY—Yes. I will summarise my pursuit of this. Thank you, Mr Chairman, for allowing me some time to do it. I am saying that the whole issue of regulation relates to the preservation of information in a form which is required by law or is necessary to produce revenue or to fulfil regulatory needs. I am asking whether you are alert to now looking for gaps in the proper retention of information over and above what is statutorily required now and whether you are interacting with the ATO, given their new initiative, to maximise at least the on-site inspections which are going to happen.

Mr Knott—We would be happy to take that on board and look at it. We are more alert now than before you asked the questions.

Mr CIOBO—I have a question about another matter. When you spoke of compliance, I noted that there are significant compliance problems. I know that, for example, at the ACCC there was significant success in their marketing of the need for the compliance frameworks—8306 or 3806, or whatever it is—that are being established. Given the focus of ASIC—and across the board prevention being better than a cure—what steps are you taking to highlight the need across the corporate sector for a compliance program? Does a compliance program serve as a mitigating factor in ASIC's view but also from a legislative remedy point of view when it comes to a potential court action? Furthermore, do you have in place across your offices a

compliance spokesperson who companies can deal with about the establishment of a compliance framework which they can operate in their business?

Mr Knott—I wish it were quite that simple. I do not think it is. When you talk about compliance with the Corporations Act, there are so many different perspectives of that act that require compliance it would be difficult both from the company's point of view and our own to have simply one channel of interface, although it is fair to observe that many public companies now do have a specified compliance officer whose responsibility it is to oversee all legislative compliance as best they can.

Mr CIOBO—Prudential and otherwise.

Mr Knott—Prudential, securities and stock exchange et cetera. I will give you one example of that. Take managed investments, for example. There is in the legislation itself a requirement that there be a compliance oversight. Part of our licensing system is that we must be satisfied with the compliance mechanisms that are in place. Part of the future program of FSRA will be, having gone through the licensing process, to go out and surveil people with their ongoing compliance. That is just one example. Others may wish to speak of other parts of compliance with the corporations law. We have a significant number of different programs running at any one time directed to compliance with the Corporations Act or to parts of it. Financial reporting is an example. We have an ongoing series of programs alerting the market that we will be looking at this aspect or that aspect of the AASBs—that we will be focusing on their compliance with the new requirement, for example. We will do it in the consumer protection area on particular parts of compliance. So I think the general answer is that it is too simple to think we could simply have one person you speak to if you have a concern about compliance.

Mr CIOBO—I understand that. I guess my focus, then, is that if it is a requirement with MIA for there to be a compliance program of sorts in place, how do you account for the disparity, then, between the results that I see in terms of breaches and the requirement for there to be a program?

Mr Johnston—I will elaborate on the chairman's comments and then come to the question. In respect of the financial services regime generally, there is, as the chairman said, a requirement that there be adequate compliance mechanisms put in place for people providing financial products or issuing a financial product. We have given guidance to the industry referring to the Australian standard on compliance, to which you referred, to say that that is something to which they should have regard in putting together their compliance framework. We have not mandated, because the law does not mandate, that they have to meet that standard, but it is something to which they should have regard. In the MIA, as you say, there has been over the past few years a requirement that there be compliance plans. Those plans are things which we see and which we measure performance against.

Part of your earlier question was about how we communicate with the regulated population in respect of that. In respect of managed investments, we conduct a targeted surveillance program, whereby we look on a risk basis at the sort of activity that is taking place in the sector. We always, at the end of those campaigns, publish the results. We have regular liaison meetings with the industry body and, more widely than that, where we invite industry participants in—every quarter, in fact—and we tell them the results of the campaigns. We tell them about the

behaviour that we have observed and where we think there are deficiencies in compliance within the industry. So there is regular feedback to the industry.

When you talk about the behaviour that you observe, I am not sure exactly what are you referring to. But if you are talking about the sorts of actions that have arisen as a result of those compliance campaigns, there is always a fairly high proportion of corrective action that has to be taken by the people on whom we carry out surveillance. But that can create a misleading impression. Over the past couple of years in respect of our targeted surveillance program, 80 per cent of the participants on whom we have carried out surveillance have been required to take some form of corrective action. That seems very high, but that is because it is a targeted, risk based program. It is not a random going around the industry completely every year, but it is actually looking at where we think the risks are high and at the participants whom we think are more risky than others. You would expect to see and hope to see a high proportion of corrective action taken. That goes from everything from collecting disclosure to us taking away someone's licence to issuing or launching a prosecution.

Mr CIOBO—If you have 80 per cent or thereabouts of people who require compliance, that is still high. The fact that it is targeted is largely an aside.

Mr Johnston—No, sorry. I do not think it is an aside. We use our risk mechanisms to identify those people we should be looking at. That means that they are at the risky end of the scale. We would expect there to be a result in the majority of cases we look at. It is not the case that we are spreading that evenly around the regulated population.

Mr CIOBO—Sure. Why would they not have compliance frameworks in place already?

Mr Johnston—They would have to have it in place. Indeed, often the remedial action we require is for them to revise their compliance framework. So they do have it in place. It would mean that we think it is either defective in some way or that they have not abided by the compliance framework. Often it is simply that they need to tighten or improve it. Sometimes we require people to retain an external compliance consultant, who would then report to us on the improvements that may have taken place.

Mr CIOBO—But I do not fully appreciate that. If someone has a compliance framework in place, and 80 per cent of people are in some way required to have it tightened or need to make adjustments or amendments to it and so on and so forth, doesn't that indicate there is a significant systemic problem with the compliance framework that exists in that particular sector?

Mr Johnston—No. I would not say it does, not in the sector.

Mr CIOBO—I use sector in a targeted sense.

Mr Johnston—If you look at the number of entities—I cannot recall off the top of my head how many managed investment schemes, for example, there are—it would only be a very low proportion of the population where remedial action is required. But it is a high proportion of those we target. We only get to around between 17 and 20 per cent of that population a year in our targeting, but we think it is the most critical.

Mr CIOBO—It is like any policing action. Most drivers obey the road rules. You want to target those that do not. I am just wondering what steps we could take to better address the outriders.

Mr Johnston—The FSRA in itself will improve matters. The new legislation does raise the bar. There is improved reference to how tight the compliance framework has to be in this legislation. There is also the fact that it sets out a licensing regime across a sector where there are many people who did not have to be licensed before.

Mr CIOBO—Sure.

Mr Johnston—That will of itself raise the standard and tighten things further.

Senator COONEY—This might be the last time I ask a question. I saw you in the airport this morning in Australia's best city—Melbourne. I saw Henry Bosch there. I do not know whether you saw him.

Mr Knott—No, I did not, Senator.

Senator COONEY—I thought, 'There is the alpha and the omega.' It just occurred to me as I am listening here now that the corporate sector treads the righteous path much more often and with much greater care than it did of yore. I think it is because of the work that your commission has done and that Henry Bosch, with the National Companies and Securities Commission, started, following Bob Baxt, Tony Hartnell and Alan Cameron. We are going towards the top. I would like to pay tribute, if I may, to ASIC. I think it has changed the culture and changed the climate in which corporate business is done. I think it is a much healthier society as a result of all your work. I see that your deputy commissioner has done great work over the years. I saw you recently on television, Ms Segal, proclaiming in a very lucid and gentle style the sorts of things we need to know. I will take this opportunity, if I may use that expression, to acknowledge the work that you and your predecessors have done. I think Australia is a much better society as a result.

Mr Knott—Thank you very much, Senator. We will miss those interventions. You have mentioned Jillian Segal's presence here tonight. With the permission of Mr Chairman, I also wish to place on record that this will be Jill's last attendance at any hearing of the department. I also would like to have on record the enormous contribution she has made to ASIC's work over the last five years.

Senator COONEY—That is why I am leaving, of course. I thought I would not stand again when I heard that Jill was going.

Mr Knott—Thank you, Senator.

Senator COONEY—Where are you off to? I had not realised.

Ms Segal—I am off to participate in the Trade Practices Act review.

Senator MURRAY—To strengthen them, not to weaken them.

CHAIRMAN—Do you have some questions?

Senator COONEY—That was the most important. That was the heart and soul of this. I think Mr Knott wants to get to Sydney.

CHAIRMAN—He has a little while yet. If there are no questions from other members, we will finish up.

Mr BYRNE—I will ask a couple. I want to touch on some of the recommendations you made in a speech in Perth on 15 May regarding the form of accounting and auditing practices. You nominated two as contentious. The first is that that reporting obligations should be strengthened, not just reports to the regulator but those by nominated officers, such as the most senior line financial manager of the board. The second was the adoption of audit firm rotation rather than the Ramsay report proposal for audit partner rotation. Could you comment on those two?

Mr Knott—I am happy to do that. I should put it, I think, in the context of that talk, which was to the CPAs. I did make it clear in that talk that I was not, on behalf of ASIC, putting down a firm list of positions that we thought were unnegotiable. What we were trying to do was put a framework for debate and put some propositions on the table to stretch that debate, really.

The points I made on line management were that experience would show generally that most misconduct in companies of the type we have seen in the last couple of years requires complicity by senior line management, particularly senior line financial management. Often that complicity is brought about by feelings of inadequacy on their part about how to avoid it. I was raising the possibility that those people should be under some obligation to the regulator to report serious misconduct and be protected by parliament in doing that.

I think I said at the time that it is a fairly radical proposition, although in the insurance sector there have been in-house actuaries that have had that sort of responsibility. Reporting to the insurance regulator generally is more extensive on auditors than it is to the securities regulator. We see company officers who, in a sense, become involved in these things and who, if they had greater incentive to stand back and say, 'No, I have this particular obligation', just might be able to stop something happening that otherwise goes through. That was that issue.

With regard to rotation, I did say that as a principle I thought firm rotation should be considered. I explained my reasons for that thinking. I think that is right. I have not changed my view about it. I also said in that talk that we have to be practical, particularly in the context of the consolidation of the industry. We now only have four major firms. Frankly, rotating those firms for international audits is going to be very difficult. We cannot afford to be ahead of the rest of the world. Perhaps I should not concede the ground too quickly because I still want the debate to at least look at the pros and cons of firm rotation. But I do emphasise the caveats on that as a practical suggestion.

Mr BYRNE—Do you see that as being more effective than partner rotation that was mooted in the Ramsay report?

Mr Knott—In principle it is. If we lived in a world where firm rotation could practically be implemented, I would advocate it even more strongly than I currently have. Partner rotation is to be encouraged. In fact, we long sponsored that notion. But it has limitations. The capacity of a partner in a firm to replace one of his or her colleagues and revisit fundamental audit treatment is limited.

Mr BYRNE—I am also looking at some comments that Professor Collier made in terms of corporate misbehaviour and recent actions that were taken on the HIH issue, to the effect that ASIC would send a message to the marketplace that unlawful conduct would not be tolerated. I think there was a submission to the MIA inquiry that suggested that corporate governance had been undermined by the MIA and that the chief issue the independent auditors failed to address was fraud by directors. What are your thoughts in terms of that?

Mr Knott—As it happens, we have Professor Collier present. I am not sure that Professor Collier has actually been introduced to other members of the committee. I apologise for not having done that earlier. I am not familiar with the particular reference that is being made to her comments.

Prof. Collier—Perhaps you could refresh my memory of the context.

Mr BYRNE—It was a speech in April. I think it was also in media release 02/192. It was after the Supreme Court of New South Wales had issued orders against the former directors of HIH on 30 May. That is the information I have. I think the talk was delivered at the Institute of Chartered Accountants on 27 April 2002.

Prof. Collier—And that was in Perth?

Mr BYRNE—You were remarking on that case, and you were saying that ASIC would take action to send a message to the marketplace that unlawful conduct would not be tolerated. The speech was headed 'Risk and responsibility'.

Prof. Collier—I see. That was the chartered accountants on the Gold Coast.

Mr BYRNE—I have not got the location.

Prof. Collier—I do not have that the speech in front of me, so I cannot remember the exact context in which I spoke. Basically we were referring, as I recall, to the action taken by ASIC in relation to the PEE matter and HIH. All action taken by ASIC in these high profile matters is intended to send a message to the market in such a way as to discourage unconscionable or inappropriate conduct by market participants and industry participants. That is all I was really saying.

Mr BYRNE—Do you want to comment on a submission made to the MIA inquiry about the Ramsay report on the independent auditors failing to address the central problem, which was fraud by directors?

Prof. Collier—At this stage, I would rather not, unless there is something in particular you wish me to comment on.

Mr BYRNE—I am not sure whose responsibility this is. In terms of directors meeting their responsibilities, is there a general view by ASIC that that is being met?

Mr Knott—I will intervene. What has confused us in trying to address the question is that I doubt this was related to an MIA submission. It is more likely to have been one of the submissions made in response to the Ramsay report. Certainly there have been parts of the community and parts of the accounting community, frankly, that have said, 'There is too much emphasis on accountants and auditors here. The prime villains in all this are directors or managers.' As a fundamental proposition, that must be right; the first responsibility for corporate misconduct lies with the management and the board that is in control of the ship. On the other hand, it has been a bit disingenuous at times for the accounting profession to simply use that as a way of avoiding the debate on accounting and audit. In the early stages of the debate, I think there was too much of that. There has been a significant shift in attitudes in more recent months.

Is there enough attention to fraud and misconduct? Our view overall is that, yes, the laws we have to address it are fundamentally adequate. There are aspects of the laws relating to disclosure to the market where we have put some other submissions or thoughts into the market for debate. We understand that the minister intends to explore some of them as part of potential law reform. He made that indication to a parliamentary committee a week or so ago.

I do not think the current position is perfect. But the result that ASIC achieved in the PEE case, which was the first significant case to explore directors' duties since the business judgment rule was inserted into the Corporations Act, was very important. It was very important to achieve the sort of outcome we did and show that directors will not be able to hide behind the business judgment rule when they commit serious, and we would say blatant, misconduct of their responsibilities.

Ms Segal—I might add one small comment. The issue of fraud and the issue of audit are also connected. One of the useful outcomes of the present debate, which is linked to the matter of whether it is firm rotation or partner rotation, is also the question of the work that is commissioned of the audit firm—how broad that work is, what the scope of audit is and who commissions the work, be it the management, the audit committee or the board apart from management. Recently, I think there has been a fair amount of debate as to whether audits should indeed include not only compliance with the standards but also the issue of fraud. I notice that some companies are saying that they intend expanding the audit mandate to include fraud. There is an interest on the part of many company boards that that be detected themselves. They have as much of an interest as the shareholders do in having that detected. But it is a question of who is there to do so. It is quite an interesting link between the two that has emerged in the recent discussions about the role of audit.

Senator MURRAY—You will be happy to know that I tried to put an amendment to the Corporations Law three or four years ago on that front. I failed, but I will try again.

Ms Segal—Time moves on and the debate moves on.

CHAIRMAN—I will raise the issue of the status of accountants under the Financial Services Reform Act. We received, in relation to our inquiry, submissions from individual accountants

and also from the Institute of Chartered Accountants and CPAs regarding this issue of when they were required to be licensed under the act and now under the regulations. They were expressing some concern about that and the extent to which they may be required to be licensed. This is where they do not think they should be required. There also seems to be a lack of clarity as to the issue generally at this stage of proceedings. As recently as last Friday, I received a representation from Ross Cameron, a former member of this committee and now parliamentary secretary, on behalf of one of his constituents, who had previously made a submission to the committee. You put out some statements during May in relation to the issue, but it does not seem to have clarified the issue.

Mr Johnston—It has been an issue. We are aware of the fact that the various accounting bodies have expressed concern. We will look at the history. The parliament passed the legislation saying that anyone who provided financial products advice or who dealt in a financial product had to be licensed. The accountants' concern is whether or not their normal activities might bring them within providing financial product advice. Under the old legislation, there was what we can call an exemption, whereby they did have some special consideration. There was then a regulation passed under FSRA, which was intended to give them some comfort. It has not given them as much comfort as the industry would like. ASIC will shortly publish some further guidance—the regulation, of course, was a Treasury matter—to give a better indication as to where we believe the line might be crossed in respect of financial product advice and the activities of accountants.

I think it is right to say, though, that the government's intention is that if they actually do give advice and are advising people in respect of financial products, they should be licensed. What we will try to do is give some clarification as to what activities they perform that will not come under that, which I guess by implication will give guidance as to what will come under it. The normal activities of accountants in respect of advising on the preparation of accounts, audit preparation, tax, normal business planning type activity and advice are not the sorts of business that we would be interested in and where we think they would need to be licensed.

CHAIRMAN—I want to raise with you a subset of that issue. This is in one of the submissions to our inquiry. It seems that the big end of town is using the FSR Act as a means to win away from clients the administration of self-managed superannuation funds. It might help if I read the letter. I do not know whether you have seen it or not.

Mr Johnston—We might need to take it on notice, in that case, Senator.

CHAIRMAN—It says:

Recently I attended a seminar run by a large bank in Sydney, where at this seminar—

this is an accountant writing—

a speaker was from one of the bank's wholly owned subsidiary companies that specialised in the administration and management of super funds on behalf of clients, bluntly stated that we as accountants could no longer conduct the administration of our clients' small self-managed super funds. The result of this seminar is that clients who take their work to this type of institution will then say that if we as accountants cannot do part of their work, then they will just take all of their accounting and tax work and give it to the financial offshoots of the banks and we are then deprived of our income and professional livelihood, which I am sure was not the intent of this particular legislation, but is the intention of the large financial institutions.

Mr Johnston—I do not think I have seen that letter. I do not know whether Mr Rodgers and others have. As I say, we will be issuing further guidance shortly. I would rather not go too closely just now into what that might say because we are still formulating what the guidance might be. As I say, we are trying to make sure that we spell out with some degree of specificity the type of activity in which we would not be interested. We will do what we can to be helpful.

Mr Knott—My only other observation is that it could never be right, of course, to say that the accountants can no longer do this.

Ms Segal—They are still licensed.

Mr Knott—They are licensed, and they can do it. I am not suggesting they would need to be licensed just to do that activity.

CHAIRMAN—I would have thought the administration and management was advice too.

Mr Johnston—Administration is a separate issue and is unlikely to constitute advice. That would be right.

CHAIRMAN—Obviously, the big end of town seem to be putting this argument. They are using it to clients to win their self-managed super fund administration away from the accountants. It is something that needs clarification fairly quickly to make it clear in the marketplace that that is not necessarily the case.

Mr Johnston—We will do what we can. I am not sure that I can pretend that ASIC will be able to settle this issue. The parliament has evidenced an intention in respect of people being licensed if they do give advice. The regulations have not given a wide exclusion to accountants. We will be giving guidance that says, 'We are taking into account the law and the regulations. Here is what we think the position is,' but it will not be able to go into every single instance of activity that accountants engage in. But we will do what we can.

Mr Knott—What we can do is say that if we become aware of the law being misrepresented to the disadvantage of particular groups, we will do what we can to correct that misperception. Whether it be by some sort of release or formal advice that people can quote, we will do that if we can. If there were blatant misrepresentation of what the law requires or it was being misused for commercial purposes, we would do what we could to redress that.

Senator MURRAY—Unfortunately that letter does not mention the bank. Otherwise we could dob them in.

CHAIRMAN—He does say he tried to contact Mr Johnston and was told that Mr Johnston was unavailable to speak to members of the public. Eventually he spoke to Pauline Vamos. She said that ASIC cannot give advice and that he would have to pay for his own legal advice. He said that he has even tried to do that, but there is really no legal advice on this matter because it still has not been resolved.

Mr Johnston—I can assure you that I speak to the public on many occasions.

CHAIRMAN—That is what I thought! I do not know where that came from.

Senator MURRAY—It is a great experience, isn't it?

Mr Knott—We will take it on notice. If we do not already have the letter and you would like to copy it for us—

CHAIRMAN—It would have been published in the submissions to the inquiry. The other issue I would like to raise in relation to the Financial Services Reform Act is a written submission and evidence we received from Mr Murphy, Mr Nowak and Mr Mitchell from the Association of Financial Advisers. Are you aware of the evidence they gave at the hearing?

Mr Johnston—At the hearing a few weeks ago? I was not there for the evidence. I have perused the transcript, however.

CHAIRMAN—There are several issues they raise. There is the ongoing issue of the protection of the capital base of their business under the transition to the new arrangements—the client based transfers from them to the licensed provider. Mr Mitchell has been advised that his arrangement with the licensee is going to be terminated because the cost of compliance under the new act will be much greater. Therefore, they no longer wish those agents that are only returning small amounts of business to them to be part of their business. So there are a range of issues. We sought in the legislation to deal with them by putting in an amendment to protect the privacy of insurance agents coming under the new regime by providing that the benefits which accrue under their existing contracts should continue. It seems that the major financial institutions are seeking various ways to avoid what we regard should be ongoing responsibilities and commitments to them in terms of commissions and so on. What opportunity have you had to consider that issue?

Mr Johnston—I do not think we have had an opportunity. Bearing in mind the number of licences that have been issued and to whom they have been issued, none of the big end of town are yet licensed.

CHAIRMAN—This is the point they are making to us; that is, the big end of town are going in and saying, 'We want this all fixed by 30 June. You've got to sign on with the new arrangements by 30 June,' when in fact the legislation states that they have a two-year transition before they really have to do anything. Again, they are using the legislation perhaps improperly as a stick to beat their agents around the head with.

Mr Johnston—I am not sure what sort of response I can give you just now. We would need to see what their submission was. I do not believe—

CHAIRMAN—I think we have also written to you about it.

Mr Johnston—You may have. I do not believe I have seen that yet.

CHAIRMAN—We did as a committee. We first received it about five weeks ago. It was sent on with a covering letter from me as an issue to raise with you to seek a response as well as putting it in the submissions to our inquiry. It would be in your system somewhere.

Mr Knott—Again, we will take that on board and come back to you.

CHAIRMAN—I am quite happy for you to do that. The twin peaks structure—are we far enough into the operation of that now to make some assessment of how it is working? Last year when I was in London, I met with their regulatory authorities. They were still of the view that there were deficiencies in the twin peaks structure and they preferred their new system. I think they raised with me the equitable life issue. That issue in effect reinforced their view that the twin peaks structure was not the appropriate structure for regulation and that you needed to have a single structure. Have you had a chance to assess where the balance lies?

Mr Knott—I am tempted to quote back to you the opening comments you made about the officials not being asked to comment on government policy.

CHAIRMAN—Perhaps in an operational sense rather than a policy sense I will ask you to comment.

Mr Knott—That is actually an important qualification to have made. I do think it is essentially a matter of government policy. It is also, of course, something that is under examination by a royal commission. At least it is my understanding that the royal commission, in terms of items 5 and 6 of its terms of reference, will make some inquiries about it, form some judgments and express some views potentially about the Wallis outcomes generally, which could include twin peaks, I think.

By and large, from an operational point of view, we would say that it is working well. We have to judge it from the perspective of ASIC. I think it would be wrong for me to be commenting on the perspective of APRA. They should answer that, or others should make an external judgment. But, from where we sit, it has been working well. We are doing better where the jurisdictions overlap. That is primarily superannuation, which has been the most problematic, and always was going to be. I think we are doing better as two agencies in getting together on some of those issues, to some extent with the benefit of seeing some difficulties that have arisen and some criticisms that have been made.

Overall, I do not think the problems we have had to cope with would necessarily have been different under a different structure. Whether that is true of APRA and the sorts of issues they have had to cope with, I really cannot say, or at least I do not think it is appropriate to voice a personal opinion on that right at this time.

CHAIRMAN—The final issue I would like to raise—it is probably Peter Kell's area—is about Nigerian money scams. What are we doing in terms of combating them? Have any Australians been defrauded in recent times?

Mr Kell—We certainly continue to receive regular referrals of Nigerian money scams. I notice they have moved well beyond Nigeria now to many other African nations. To my knowledge, these scams have become so well known that consumers in Australia are very unlikely to fall for them. I am not aware of any recent occurrences where consumers have fallen for such scams.

However, unfortunately, there are a range of other quite damaging international scams out there. We will be releasing quite a major report soon on the international share cold calling investment scams, where there have been very significant sums lost. That has well and truly taken over as the most damaging scam around. Unfortunately, they are considerably more sophisticated than the Nigerian letter scams, although perhaps not quite as entertaining in the way they are constructed.

CHAIRMAN—You are saying that no Australians, to your knowledge, have fallen for the Nigerian scams anyway. If they did, is there no capacity for the Nigerian authorities to prosecute, or are they unwilling to prosecute?

Mr Kell—My understanding is that there have been some discussions with the Nigerian authorities, not necessarily just originating from Australia. As you are probably aware, these scams have an impact all around the world and over quite a long period of time. I think the estimate is taken of somewhere in the order of $5 billion globally, which is quite astonishing. I think the Nigerian authorities have pointed to the fact that, as seems to be the case with quite a lot of international scams these days, they are established in such a way that they are not necessarily based in one country but cross several jurisdictions, which means that they are difficult to take on. They are also run by a fairly violent criminal element, as far as anyone can determine. So they are not matters where you would take action lightly.

We certainly have raised the issue in international fora but, as with all the best scams of an international nature, they are difficult to take on. We have had more success more recently, as I said, with the share scams. As you may be aware, there is action currently under way in several Asian jurisdictions in relation to those scams. Given their more recent impact on Australian consumers, that is where we have been focusing some of our energy of late.

CHAIRMAN—Australians have got involved in those as consumers?

Mr Kell—Very much so. A lot of money has been lost. As I said, we will be releasing a report very soon which will outline the dimensions of that scam and what we have been doing about it.

Mr BYRNE—I have one small final point. We have received some representations from the Police Credit Union about the inspection of the members register. I think it has been drawn to ASIC's attention that there are two registers. I think one is general public access and one you cannot get access to unless you have ASIC approval. The Police Credit Union are concerned that ASIC then can facilitate information that might be deleterious to the police members' security.

CHAIRMAN—And prison officers.

Mr Johnston—I have seen the correspondence, but only today. It is something that we will look at. The law provides that companies must make their registers of members available. There are then some regulations in respect of non-banking financial institutions such as friendly societies and credit unions. They have put some restriction on that and allow ASIC to approve a purpose for which the register is made available. We, on a case-by-case basis, have been asked to approve such purposes from time to time. Where we have been satisfied that the purpose was

legitimate—for example, members wanting to convene a meeting to put a motion in respect of the management of the entity involved—we have given approval.

I understand that the nature of the Police Credit Union concern is that, because of the nature of their membership, it will make the names and addresses of police available. But we have not received an application in respect of making that register available. We would consider it when we did. I believe, going back some time, that that body and the credit union representative body made representations to government in respect of this matter. But the law was expressed in the way that it is; that is, that they should be made available. ASIC can give approval of the purpose that is sought but we do not actually give specific approval to the making available of the register. That is still a matter for the credit union or society concerned.

Mr BYRNE—Do you have general guidelines? I guess it is difficult. Are there any provisions that you can think of incorporating, in terms of the framework for the discretionary guidelines, that might offer the Police Credit Union some level of assurance or further protection to those who have concerns about their security?

Mr Johnston—Not at the moment. As I said, I only saw the correspondence today. I think it has only recently come in to us.

Mr BYRNE—Could you take it on notice and respond to us.

Mr Knott—We will certainly do that, but I should perhaps add that it can be quite a difficult situation for us. We are very cautious about it. The last example that I am aware of related to a building society—but it is the same issue—where another entity wished to make a takeover bid to members. In most companies, it would be possible to go and search the register for this purpose to ensure that the shareholders at least had the opportunity to consider an offer of some sort.

The difficulty with the mutuals is often that the names and addresses will provide customer information. Even putting aside the police problem, if you are disclosing your full register you are really disclosing your customers. So it could be misused by somebody with no genuine purpose but just a commercial purpose. On the other hand, we would not, in the example I have just given, wish a board to deny its members the right to consider a legitimate offer. So in a situation like that, one might be thinking about introducing a third party to act on behalf of the bidder to gain access to the members to enable documents to be sent but for that information not to be made directly available to the competitive society. So the issues are quite complicated in the mutual area.

Mr BYRNE—But that could be a mechanism to address some of their concerns, couldn't it, in terms of having a reliable third party that then passed that offer on?

Mr Knott—It could.

Mr BYRNE—Is there some provision—I am not sure of the law; I am very unclear about this—where people choose to be silent members, as there are silent members on the electoral roll? We have a similar situation where people are concerned about the disclosure of their address. Could that not be the case, say, within the credit union? To cover yourselves, you

would have an independent third party. If there was a takeover offer or some sort of general information, that third party would relay that to those silent members so that at least you had some level of protection?

Mr Knott—We will take on board the particular issues that might relate to security-type concerns. I can understand that police credit unions would have them.

Mr BYRNE—You will come back to us in terms of your investigations?

Mr Knott—Yes.

Senator MURRAY—I have one last question. It concerns takeover panels. Does ASIC take note of takeover panel views when you are conducting investigations into matters where the takeover panel may have had a part to play?

Mr Knott—I need you to expand that question, please.

Senator MURRAY—We had a complaint from someone—I do not think I should mention them at this stage—who maintained that there were investigations into allegations of breaches of the Corporations Act. The takeover panel made one set of rules and ASIC took a different view. To what extent do you take into account the takeover panel's views?

Mr Knott—Depending on the circumstances, the takeover panel's views may be the determinative ones. For example, if a party has applied to us for relief of some sort or for the exercise of a discretion, and we exercise it in a certain way or fail to exercise it in the way the party wishes, and that matter then is reviewed by the panel under their power of review and they come to a different determination, that will be binding as a matter of law.

Senator MURRAY—As I understand it, it could be the other way around—in other words, a decision could be made by the takeover panel and subsequently there could be an allegation to you of wrongdoing. You would then investigate whether there was a breach of the Corporations Act. Would you in that case —I accept you could take a different view; that is entirely proper—take account of the takeover panel's consideration?

Mr Knott—We might. I do not know whether we are talking in riddles here about the same case. I will give you an example. There is a case well known to us which is the subject of quite persistent representations to us. We ourselves examined it and formed a view that was not to the satisfaction of the complainants. They then went to the takeovers panel, which actually formed the same view. Our position in relation to those complainants is that the matter is now at an end. That is not precisely on point with the possibility that the panel may have, either in an instant case or some previous case, made a ruling of a particular type and the complainants come to us in respect of a similar matter and say, 'We want you to investigate it.' We would not just dismiss an investigation because of something the takeovers panel had done. But I suspect that we are talking about the same case. If we are, I can assure you that it has been exhaustively reviewed by us ahead of it being reviewed by the takeovers panel. They happen to have come to the same conclusion we have.

Senator MURRAY—This committee, as you would expect, is experienced in the matter of representations we get. Generally speaking, they have been elsewhere. But at times we must ask the question and I do not think it is right for me to go any further.

Mr Knott—Thank you, Senator.

CHAIRMAN—If there are no further questions, before concluding I reinforce the comments made earlier by Senator Cooney and by you, Mr Knott, with regard to Ms Segal's period of service with ASIC. I commend her for that. She has certainly been a strength, I believe, for ASIC's work over the period that she has been on the commission. On behalf of the committee, I thank you for that, Ms Segal. I thank you for the responsiveness you have given to the committee in the times you have appeared before it. I also wish you well in your new role.

Ms Segal—Thank you very much, Senator.

CHAIRMAN—Senator Cooney is absent. I will also thank him. This will probably be the last public hearing of the committee which Senator Cooney will be involved with because he retires from the Senate on 30 June. I would also like to publicly thank Senator Cooney for his work on the committee over many years.

Mr Knott—Hear, hear!

CHAIRMAN—He has been a very valuable member of the committee. I apologise, Mr Knott, again for somewhat inconveniencing you and thank you for being with us for this evening's hearing.

Committee adjourned at 9.32 p.m.